

## **Xiang Junbo: Harmonious financial development – the expectation of the world's economy and financial industry**

Speech by Mr Xiang Junbo, Deputy Governor of the People's Bank of China, at the Opening Ceremony of Lujiazui Financial Culture Week and Lujiazui International Financial Forum, Shanghai, 1 September 2006.

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Honorable Deputy Chairman Jiang Zhenghua of the Standing Committee of NPC,  
Ladies and gentlemen,

I'm very pleased to attend this Financial Culture Week. My topic today is *harmonious financial development: the expectation of the world's economy and financial industry*. And I'd like to speak from the following three aspects.

### **First, the enormous contribution China has made in the balanced global economic development.**

China's economy has achieved sustained and rapid development in the past two decades. With the increase of aggregate strength, China is playing a bigger role in the world's economy. In 2004, China became the sixth largest economy with its GDP accounting for 4.4% of the world's total output. In 2005, China became the world's fourth largest economy. The size of China's manufacture industry ranks the fourth in the world, and the output of more than 170 sectors ranks the first. In 2005, China's external trade ranked third in the world, accounting for 6.5% of the global aggregate. In 2003, the FDI inflow, for the first time, surpassed that into the US to become the largest in the world; in 2005, foreign investment in China accounted for 6.7% of the world's total. Between 2002 and 2004, China's contribution to global economic growth was 13.8%, 16.7%, and 14.5% respectively. It is fair to say China's rapid economic growth is becoming more and more important to global economic stability and growth.

The global economic imbalances have become one of the major issues confronting the world's economy, as reflected in the huge current account and rising fiscal deficits in the US on the one hand, and continuous expansion of trade surplus and foreign exchange reserves in some Asian economies and major oil exporting countries on the other. The causes of economic imbalances are very complicated and to resolve it requires concerted efforts. In recent years, China has, with a view to improving the balance of BOP, adopted various effective measures to boost domestic demand, reduce savings rate, increase import, open up market, and reform the exchange rate regime. With respect to domestic demand, measures such as tax reduction, increase of household income, speed-up of rural infrastructure building, and expansion of financial service to individuals were adopted. And we have also quickened the pace of reform of pension system, health service system, education system and the cultivation the residential mortgage business in order to lower savings rate. All these measures indicate that China is seeking to rely less on export and more on domestic demand to achieve growth. This will contribute to a more balanced development in China and the world at large.

The sustained and rapid development of China's economy has played an important role in the balanced development of global economy. Global consumers have benefited a lot from good and cheap goods from China. Companies especially the multinational ones get great profits from their investment or trade with China. Some western economists have pointed out that it is the good and cheap Chinese exports that made 10 years of low-inflation and continuous economic growth possible. According to the estimates of the European Central Bank, without the positive factor of cheap Chinese exports, the price index of the Euro zone would have risen 2 percentage points on average from 1996 to 2005. At the same time, China's economic development pattern characterized by high input, high energy consumption and low domestic demand has brought about domestic imbalances. In terms of industrial structure, some capital intensive sectors such as the manufacturing sector have witnessed rapid development and become engines of China's economic development. But agriculture and modern services have lagged behind. With respect to regional development, while the coastal areas in East China has put in place a virtuous economic development mechanism, vast middle and western areas have developed relatively slowly. As for the driving force of economic development, despite high investment and export growth rate as well as excessive energy consumption, growth of China's per capita national income has been slow, and domestic consumption remains slack. Some rural areas even haven't got out of poverty. So China's economic development mode must be transformed to

support balanced development between eastern, middle and western area as well as urban and rural areas through boosting domestic demand and a new type of industrialization.

**Second, harmonious financial development is an important part of the balanced economic development.**

Financial industry is the core of modern economy. Linking commodity market with factors of production markets and bridging production, distribution, and consumption, finance plays an essential role in resource allocation. With the deepening of China's economic reform, financial industry became more and more market oriented, and the enhanced role and position of financial industry enable it to contribute more to sustained economic development and global economic adjustment.

First, we have built a diversified and multi-layered system of financial institutions and of financial market that supplement each other. At the end of 2005, the total assets in both domestic and foreign currencies of banking sector, securities sector and insurance sectors combined reached 5 trillion US dollars, about 2.5 times of GDP. The assets of the banking sector stood at 37.5 trillion RMB, 2.06 times of GDP. At the same time, the development of money market, capital market and insurance market also made headways. The non-tradable shares reform progressed smoothly, and some institutional issues restricting the development of capital market has been gradually resolved.

Second, the improvement of financial macro-management system has helped support the stable and rapid development of national economy and maintain price stability. Market-based interest rate reforms have made important progress with financial market interest rates basically liberalized. The upper limit of lending rates and lower limit of deposit rates have been liberalized, and financial companies have more autonomy in pricing.

Third, the reform of exchange rate regime has advanced significantly. On July 21<sup>st</sup>, 2005, China reformed its exchange rate regime and adopted a managed, floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Practices have proved that this reform are consistent with the fundamental and long-term interest of domestic and global economy, and reflects the direction and goal of China's market-oriented reforms.

Fourth, the shareholding reforms of state-owned commercial banks produced good results. The CCB and BOC have been successfully listed in Hong Kong, and BOC also issued A shares in the domestic market. The ICBC has already established a shareholding company, and the value of domestic financial asset has been maintained and increased.

Fifth, the opening-up of the financial industry is conducted in an all-around way, and international financial cooperation has been improved. At the end of 2005, 25 foreign banks made equity investment in 20 domestic banks, and some foreign banks or investors invested in several banks. The number of cities that have been opened for RMB business has increased from 18 to 25. China has fully fulfilled its WTO commitment with respect to market access and business scope in securities and insurance sectors.

China is still a developing country in transition despite its achievement in financial reforms and development. There are many issues and challenges facing the financial industry. The financial industry cannot fully meet the requirement of economic development in the process of transforming economic growth pattern. More efforts should be made to build a harmonious financial system compatible with the comprehensive, balanced and sustainable economic development. To be explicit, we will make efforts in the following aspects:

First, harmonize the relationship between economic and financial development. The ultimate goal of financial development is to promote economic development. So the scale and structure of financial industry should serve the need of economic development. But at present, the development of China's financial industry is lagging behind. China's share in international financial market is still very limited despite its increased involvement. The trading volume of China's foreign exchange market is very small compared with the \$2.41 trillion trading volume per day of the global forex market; The trading volume of China's stock market is only 1% of the daily transaction in international stock market; The trading volume of China's bond market is only 3.7% of the outstanding balance of bonds in the US market, and bonds in China are far less diversified; The spot transaction volume of the Shanghai gold exchange, although large, is less than 1% of the London gold market. So we should pool our efforts to enhance the weight of financial industry in national economy. And during the process, we should well handle the relationship between scale expansion and risk prevention, scale quality and scale profit, improve ability of management and risk prevention, cultivate the virtuous interaction between finance and economy, and thus build up the harmonious relationship.

Second, foster a harmonious system for financial institutions. The soundness of this system means financial industry can satisfy the needs of participants at different levels. Banking sector especially big banks still dominate the financial industry despite the relatively complete financial system. Small and medium sized companies, especially small ones with innovative capability can not get loans from prudently managed banks due to their uncertainty in development and the lack of credit record and production scale. And this limit of China's financial system hinders its shift from investment-driven growth to one driven by technology advance and pursuit of efficiency, featuring knowledge economy and information. So the system for financial institutions should be bettered so as to provide good financial service for various economic agents.

Third, build a harmonious financial market. Not a capital rich country, China's fund cost should not be very low. But current interest rate cannot reflect real fund cost due to the absence of market-based pricing mechanism. As a result, some fund-consuming and over-productive sectors cannot be driven out of market in time, and the ineffective allocation of resources exacerbates economic imbalances. An improved and integrated financial market system is the precondition and basis of effective financial resource allocation. Unless fund flows orderly in different markets, interest rates cannot reflect real market supply and demand, and energy saving, efficient industries cannot be cultivated. Various financial markets including money market, capital market exist in China, but the small number of market participants, the inadequate products, and the excessive restriction all hinder the free movement of fund among different market, and therefore affect the effective fund allocation. We need to have the development of financial markets, analyze the relationship between them so as to enhance the balanced development between basic financial product market, derivative market, money market, capital market, foreign exchange market and home currency market.

Fourth, promote the development of regional financial industry in a harmonious way. Financial development is an important force driving regional development. Sufficient fund injects vigor into the regional development, while the lack of it harms regional development. A comparatively sound and strong financial system and financing system have been set up in eastern China, but lending of state-owned commercial banks is still the dominant financing method in the middle and western region. In some less developed rural areas, the financial system, instead of supporting economic development, has become a major channel for fund outflow and prevented capital formation. So, regional financial development must be harmonized to promote balanced economic development. To achieve this goal, the following aspects must be emphasized. First, regional financial institutions should be encouraged to facilitate balanced economic development. Special emphasis should go to the cultivation of rural financial service system to improve the insufficient, weak financial service in rural area. Second, regional financial cooperation should also be highlighted. The influence of financial sector in developed regions should be extended, and the conflict between various regional financial development should be coordinated. Fiscal support should also be balanced with financial support to increase the multiplier effect of the latter.

Fifth, blueprint the harmonious reform, development and opening-up of financial industry. The development of China's financial industry benefits from its opening up. During the opening-up process, we have learned how to employ financial instruments and international capital to serve economic development, and domestic financial institutions have improved their management amid market competition. So it has always been China's basic policy to further open up its financial industry. China will honor its WTO commitments to open the financial industry on schedule and some commitments have already been materialized ahead of schedule. But international practice also tells us over-hasty financial opening-up incompatible with the economic and financial development will exacerbate the vulnerability of financial system and thus leads to financial crisis. This will negatively affect the world economy. Faced with many issues such as the industrial sector imbalance and the weak financing channels, China's financial opening-up will be a long and arduous process. At the same time, financial opening-up also needs a relatively relaxed international environment. We will make efforts towards this end. We also need the understanding and support from the international society.

### **Third, Shanghai's growth as the international financial center will play an important role in building a harmonious financial system**

To build Shanghai into an international financial center is a national strategy established in 1992. This strategy has two aims: one is to promote economic and financial development of the Yangtze River Delta and even the whole country; the other is to develop Shanghai into a window for China's opening-up, foreign capital utilization and international financing. Thanks to fourteen years' development, Shanghai has become the most financially advanced city in China.

Shanghai's international financial center build-up has taken up new responsibilities in the new era characterized by the shift of development mode and the harmonious economic development. A financial center basically undertakes the function of financial intermediary and is the core part of resource allocation. Home to lending, securities, foreign exchange, and insurance transaction, and sensitive to market changes, a financial center can mobilize and distribute huge funds quickly, effectively allocate financial and economic resources. An international financial center, also a center of economic and financial information, reflects regional and global economic changes, and realizes the price discovery function. The world's major international financial centers have always had the above features.

To build Shanghai into an international financial center contributes to the cultivation of a nationwide financial system, the improvement of financial organization system, the growth of financial markets, the cooperation between regional financial institutions and the further opening up of the financial industry. Shanghai's growth as a financial center will serve the whole country, and promote the stability and development of the entire global economy. We hope that the experts participating in the Financial Culture Week can come up with suggestions and proposals on transforming Shanghai into an international financial center. And we also hope this Financial Culture Week will be a bridge for further exchange and cooperation between Shanghai and various international financial centers and contribute to the harmonious economic and financial development in the world.